Modular Google Play Billing EAP
Pre-BC Exec Review

27 July 2020

EXHIBIT 1496.R

EXHIBIT 1496.R-001

Executive Summary

This deal is in early stages yet is critical for the imminent Play Billing Policy change announcement.

Ask of Don/Sameer:

Spotify's commercial principles anchor on transparent value exchange. As a result, we seek:

[1] Approval to proceed with a model that breaks out the payment processing fee from other services

[2] Approval to propose recurring fee model, with Bounty model (one-time fee) as fallback position

[3] Guidance on acceptable margin range

Recommendation (model 2B):

Recurring fee (not one-time bounty) that is bifurcated:

- One portion of fee that is tied to processing (10% if Google processes payment, 0% if Spotify processes)
- One portion of fee that is not tied to processing to capture value that Play adds (6% regardless of who processes)

- Recurring fee that is bifurcated - tied to processing, tied to not processing

Spotify's commercial principles anchor on transparent value exchange

Spotify

1. **Fees align to value-add** ***"not a tax"***
2. **Cost-effective conversion**: processing costs in line with market costs & fair fee for use of the payment platform.
3. **Right commercial incentives** for both (user growth, user choice, developer control, user trust, engagement & conversion)
4. **Scalable solution** to other subscription developers
5. **Fair treatment**: vs 3P and Google own products

Google

1. **Retain financial sustainability** (margin neutral (2% blended rev share) or better)
2. **Protect the concept of the 'value of Play'** - fees should include entire platform value, not just processing costs
3. **Defensible + low contagion risk**
4. **Framework is fair & consistent** with our policy announcement

Deal progression: Spotify returned to its principles

[1] Transparent value exchange; [2] cost effective conversion; [3] align incentives

Google's May Proposal:

Revenue:

- New Subscriber Bounty - agnostic of processor
  - *100% of sku*
  - Paid M1
- **7% effective rev share**[1]

Costs:

- Processing, infras., support
- **Processing Cap = 20% of total spend
- Max Var. Cost = **2% total spend**[3]

Breakeven:

- Derived from max cost (= 2%)
- Breakeven ~ *29% of sku*

(1) Effective rev share calculated over 5 years
(2) Assumes Google processes 20% of payment
(3) Assumes 10% processing cost

Spotify's July Counter:

Revenue:

- New Subscriber Bounty- different by processor
  - Matrix pricing
    - x-processing; x-acquisition
  - Implies: *24% - 74% of sku*[2]

[1] Transparent value exchange

[3] Commercial incentive

Qualifiers (bounty excludes):

- 90D win-back
- VAT
- M1 (Paid on M2)

Reduces Google revenue by 70%

[2] Cost effective: Spotify desire to mitigate margin risks

Outcome:

- **0.5-1.6% effective rev share**
- **Deal is uneconomic, even at the high end**

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- Maximum variable cost... and it suggests that if we process 20% of payment (at cap, under the proposal) @10%... 20%x10% = 2% of total spend
- Or 2 % of effective rev share
- Which is the basis for the threshold under the single payment structure

EXHIBIT 1496.R-004

Proposed Scenario for Counter Proposal

	Spotify	Google
Processing	0%	10%
Service fee	6%	6%

Questions we've spent time on:

- How do we frame this to Spotify?
- What should the service fee be and what is our floor?
- Why would Spotify get a service fee that is different from other developers?

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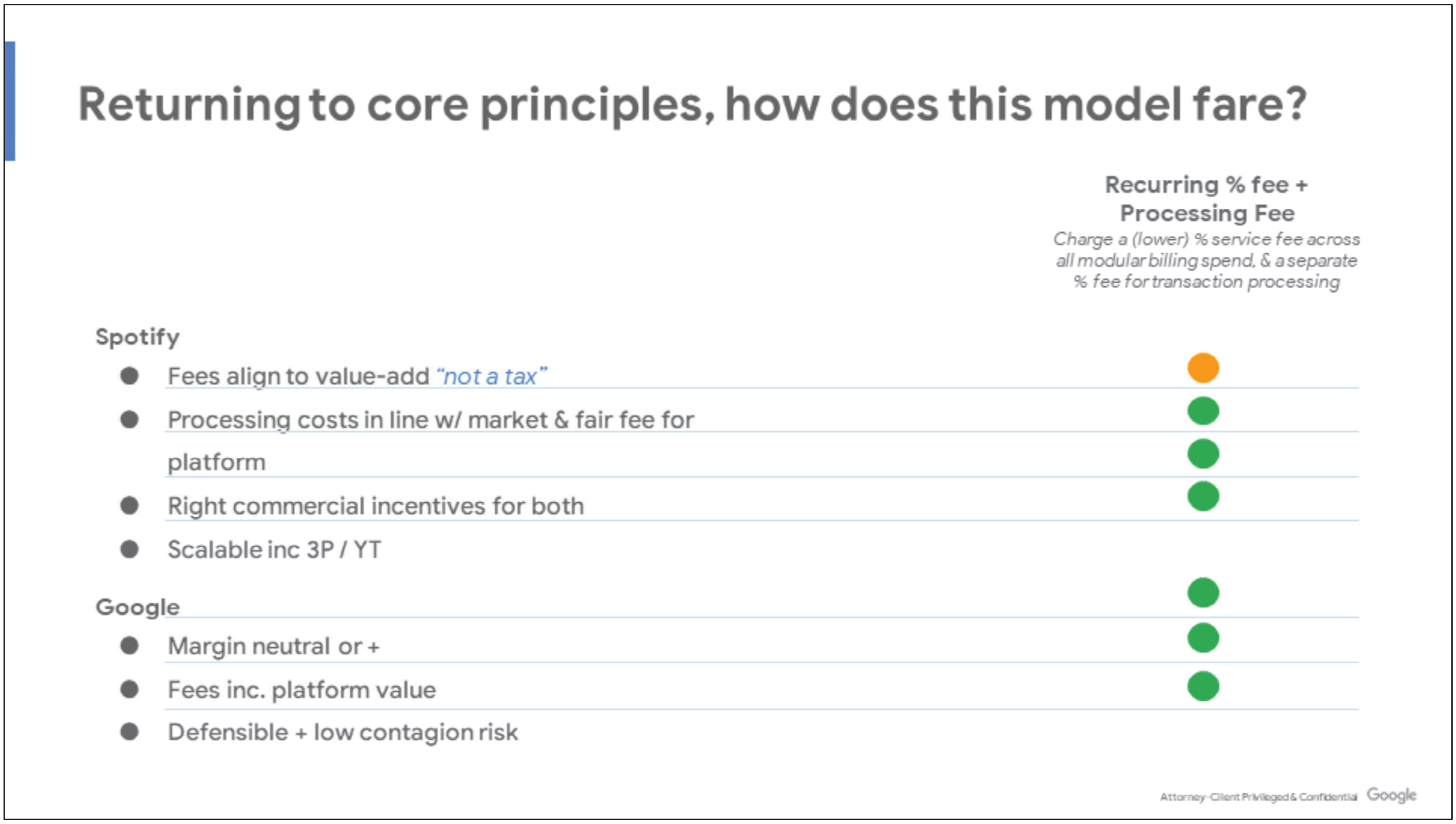
- Potential framing: "Google will charge a service fee of 6% on all transactions to reflect the value realized of operating the platform, distribution, publishing, updating, loyalty and investing in the user experience for Spotify users. In addition, we will also charge a 10% fee where and if Google enables new subscribers to transact via Play. We believe these fees represent value delivered of enabling Spotify to scale to over 2 billion users effectively and driving new paying subscribers globally"
- We believe it's important (also under advice of counsel) to charge a service fee to reflect the values of the platform outlined in the framing; we believe Spotify will negotiate on this and if we go below 6% (e.g. to 1%, which is in line with their proposal), we should consider increasing the cost of processing.
- Spotify would get access to a modular commercial model since they are part of the mGPB EAP and co-investing with us on the platform, in Cloud, in Ads, Assistant etc. Developers that meet the program criteria (currently, Netflix) could be considered to receive a similar modular commercial construct.

EXHIBIT 1496.R-005



- Not a tax:

- Consideration is that a recurring service fee would hit their margin line (vs bounty which can be added as UA)
- Need to clearly articulate the value of the platform

Slide 6

2 Or perhaps it's the "not a tax" that gets "downgraded". I think they will see any recurring charge as a tax if not articulated strongly with associated recurring services. Perhaps we can tackle this in framing. But...we'll have to explain how we got comfortable with a one-time charge and now are reverting to recurring.
Danielle Stein, 7/27/2020

1 The one time charge is not commercially sustainable for scaling and that was one of our shared principles.
Tamzin Taylor, 7/27/2020

1 @Sarah Karam (Google) @Tamzin Taylor (Google) the bounty model really appealed to Spotify in that it very clearly aligned our incentive to deliver new subscribers. I'm not sure they'll see a recurring fee as a "green" on this front
Danielle Stein, 7/27/2020

2 Also, on bounty model the higher churn they have the more they may invest to acquire users to meet financial market stated objectives. This will drive more paying users which we get rewarded for.

Also, revenue at start would be high but would plateau as growth in new subs diminishes. Yet our costs from each sub continue, eroding profitability
Tamzin Taylor, 7/27/2020

Business Model Evaluation

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	One fee agnostic of processor [1a] Google's original proposal		Two distinct processing fees Addresses Spotify's ask: Transparent value exchange	
	[1a] Bounty	**[1b] Single % Share**	**[2a] Bounty**	**[2b] Recurring % Fee**
Logistics	Charge Spotify one bounty for each new subscriber, regardless of processing (eg, one % of sku)	Charge Spotify a single rev share on total spend, regardless of processing	Charge a bounty for all new subs and a separate % fee for transactions Play processes	Charge a (lower) % service fee across all modular billing spend, and a separate % fee for transaction processing
Benefits	• Easiest to communicate to Spotify	• Easiest to communicate internally	• Eliminates processing risk • Keeps bounty structure (better for Spotify[1])	• Eliminates processing risk • Profitability maintained through deal term
Negatives	• Potential for loss on txn processing • Profitability declines over time • Risk from asymmetry of information • Against Spotify 1st Principles	• Potential for loss on txn processing (at <7%) • Against Spotify 1st Principles of paying for value	• Profitability declines over time • Risk from asymmetry of information • Exposes our business model for one partner	• Exposes our business model for one partner… but structure/price can vary, even between devs on modular billing
Finance Risk	**Margin reduced by $105M over 5 years for each additional 5% of spend processed by Google**		**Margin is *not* sensitive to changes in processing share**	**Margin is *not* sensitive to changes in processing share**

(1) Spotify prefers to classify payment as a bounty so that it hits customer acquisition cost, not gross margin

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- To recap, we are keen to get your feedback on our recommendation to :
- Propose a distinct processing fee vs services fee
- Lead with a recurring % fee reverting to bounty as a fall back.
- In this slide we've outlined how the 4 models would work, the pros and cons and the margin impacts.
- We prefer option 2b because it protects us from changing conditions and assumptions, and delivers a financially sustainable model and a construct that can be scaled to other partners. It meets spotify's need for transparent value exchange and removes our risks associated with how much volume we transact

EXHIBIT 1496.R-008

Risks and Mitigations

Risk	Mitigation
Developer leakage: This will be a new business model for Google Play and is very favorable to the developer. Other developers may want to be able to engage with Google Play in this same manner	Objective criteria for invitation into the program as well as requirements that naturally limit the developers who could participate and allow us to test the model for at least 2 years.
Model assumptions vary from reality For Bounty model, the key drivers of variability are (1) Churn, (2) net subscriber growth and the change in sub growth over time, (3) change in average ARPPU of the subscription, and (4) % of transactions processed by Google.	Est. Spotify/Google governance to meet monthly to review figures If exceeding 10% then... we have the right to renegotiate terms At worst, Spotify de-integrates and goes consumption only
Lack of visibility into user level data processed by partners Partners become 'source of truth' for financial reporting	1. Limit term to 2 years 2. Spotify to provide an annual SSAE16 type II report. 3. Spotify will provide monthly reporting to Google to supplement the payment to enable us to build analytics on a monthly/ quarterly basis in addition to the annual SSAE 16 report. 4. Termination for convenience

Discussion & Guidance

[1] Approval to proceed with a model that breaks out the payment processing fee

[2] Approval to propose recurring fee model, with Bounty model as fallback position

[3] Guidance on acceptable margin range - break even to 7%

Appendix

Objection handling

What value is included in the service fee?	● Our commitment to pilot modular GBP ● Distribution, development, updates, testing, user experience and customer support. ● Featuring / merchandising commits ● Preferential access to Google / Android EAPs (Clock, ATV, Nest, Wear, Maps..)
Why isn't the service fee dropping in Year 2 of the subscription like it does for other developers (ie 20% -> 15%)	● Because of Spotify's commitment to Google across Cloud/DVIP; its scale and commitment to pilot the M-GBP EAP, we have front ended the second year discount into the proposed service fee. Similar to LRAP & ADAP, this is a private program that enables value for value derived for users and the platform and does not lower fees in year 2.
Why is the processing fee so high?	● The fee is covering all non-card FOPs which are based on custom deals, many of which are Play exclusive like Gift Cards. ● Google supports 2x the number of non-card FOP methods vs Spotify & can unlock significantly more subscribers for Spotify. ● The fee supports our ongoing effort to continually expand our non-card FOP coverage that will support Spotify's growth, especially in Emerging Markets
Why do mGPB EAP devs get a different service fee?	● They are co-investing and innovating in the platform and Google with us and delivering significant value to users at their own cost.
Why would Spotify get a different service fee vs, other mGPB devs?	● Significant cloud, hardware and DVIP commitments; scale of their 130M subscriber business; commitment to unlock new paying users (TBD)

Evaluating different structures

Play Revenue (USD $M), assuming 10% processing

Scenario	[1a] Single Bounty	[1b] Single Rev Share	[2a] Bounty w/ Processing	[2b] Split Rev Share (w/ Processing)
Terms	100% of sku bounty @ (M1)	7% rev share	86% of sku, w/ 10% proc. fee	6% service fee, w/ 10% proc. fee
2020	200 M	70 M	182 M	70 M
2021	264 M	201 M	255 M	201 M
2022	306 M	313 M	307 M	313 M
2023	343 M	407 M	352 M	407 M
2024	360 M	481 M	377 M	481 M
Total Revenue	**1,473 M**	**1,473 M**	**1,473 M**	**1,473 M**
Modular Spend	21,037 M	21,037 M	21,037 M	21,037 M
Eff. Rev Share	7%	7%	7%	7%

1 All of these structures have the same richness over 5 years, but...

2 Rev share for the bounty models declines over time, and...

Evaluating different structures, ctd.

... only the models with processing fees adjust to the costs that Play incurs

Processing Scenarios	**Single Bounty**	**Single Rev Share**	**Bounty w/ Processing**	**Split Rev Share (w/ Processing)**
Processing %	Rev Share (as % of total modular spend)			
10%	7%	7%	7%	7%
20%	7%	7%	8%	8%
30%	7%	7%	9%	9%
Processing %	Margin (USD $M)			
10%	1,262 M	1,262 M	1,262 M	1,262 M
20%	1,052 M	1,052 M	1,262 M	1,262 M
30%	842 M	841 M	1,262 M	1,262 M

Rev share expands in these two scenarios to neutralize risk from processing fees

Evaluating different structures, ctd.

Margin equivalent deals across each structure, evaluated @ 10% processing share

Effective Rev Share	[1a] Single Bounty	[1b] Single Rev Share	[2a] Bounty w/ Processing	[2b] Split Rev Share w/ Processing	5 Yr Margin
7%	100% of sku bounty @ (M1)	7% rev share	86% of sku, w/ 10% proc. fee	6% service fee, w/ 10% proc. fee	$1.3B
5%	71% of sku bounty @ (M1)	5% rev share	57% of sku, w/ 10% proc. fee	4% service fee, w/ 10% proc. fee	$840M
3%	43% of sku bounty @ (M1)	3% rev share	29% of sku, w/ 10% proc. fee	2% service fee, w/ 10% proc. fee	$420M
2% (b/e @ txn cap)	29% of sku bounty @ (M1)	2% rev share	14% of sku, w/ 10% proc. fee	1% service fee, w/ 10% proc. fee	$210M
1% (b/e at txn est.)	14% of sku bounty @ (M1)	1% rev share	0% of sku, w/ 10% proc. fee	0% service fee, w/ 10% proc. fee	$0
0.5% Spotify Counter (low end)[1]	24% of sku bounty @ (M2)	0.5% rev share	-7% of sku, w/ 10% proc. fee	-0.5% service fee, w/ 10% proc. fee	-$105M
1.6% Spotify Counter (high end)[1]	74% of sku bounty @ (M2)	1.6% rev share	9% of sku, w/ 10% proc. fee	0.6% service fee, w/ 10% proc. fee	$126M

(1) Spotify's counter included other stipulations that are incorporated here. Included are a provision to exclude users who are won back 90 days after churning (90D winback) and to exclude VAT from bounty. **Spotify have informed us M1 payment is a deal breaker**

Evaluated @ 20% processing cap, the Spotify proposal is margin negative

Thoughts on a bounty structure

To state the obvious- *a Bounty is not a Revenue Share*!

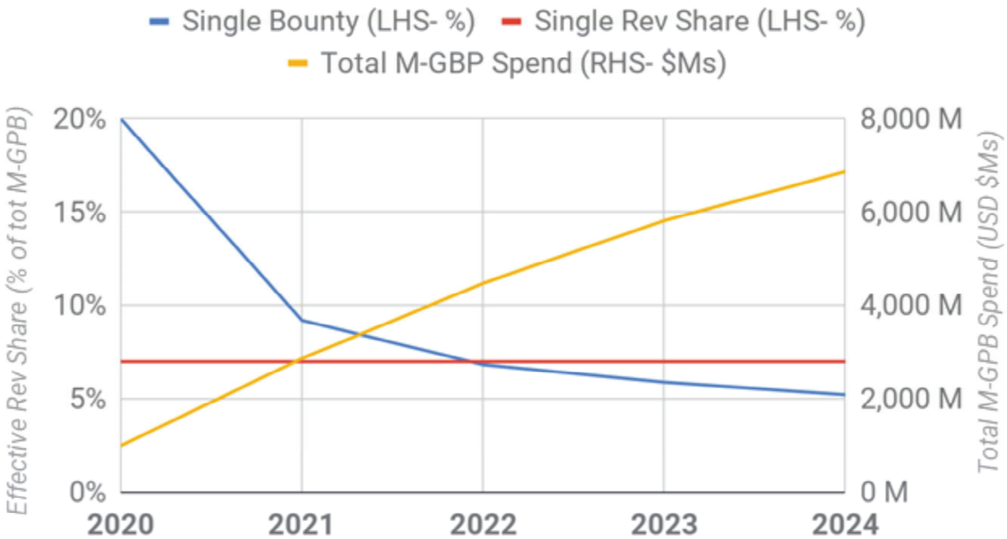
- Processing is a **liability**
  - Different mentality from Play's current business
  - Mis-match of revenue/costs exposes Play to risk
    - Receive all revenue at one point for a (potentially infinite) cost stream
- Business model drivers are different; instead of total spend...
  - Churn
  - Net Subscriber growth
  - Relative geo growth

Google profitability declines over time

- Asymmetry of information is significant
  - Spotify knows all of these inputs... we're evaluating using comparables

Bounty economics are not easily scalable

Bounty eff. rev share is front end loaded, declining over time



- Bounties are front end loaded
  - Profitability declines over the deal term
- Creates a mismatched cash flow
  - Receive 100% of revenue upfront to service a (potentially unlimited) liability
- The bounty model is not easily scalable
  - Requires a deep dive of each service's subscription metrics

Google

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Managing processing costs

- Negotiating levels (0.5%-7% rev share) are below avg. processing cost
  - Spotify has an *explicit* financial incentive to process as much as possible through Play
  - W/o a separate processing fee, ***Play is exposed to significant potential loss from processing***

FOP	Processing Cost
~~Credit Cards~~	~~5%~~
Stored Value	10%
DCB	Varies (Sq = 15%)
Weighted Avg	**8%**
Spotify Proposal	**=7%**

WORST CASE: Play processes 100% of Spotify spend

	Economic Loss (USD Ms)			
Eff. Rev Share	**2021**	**2022**	**2023**	**2024**
1%	-218 M	-330 M	-421 M	-491 M
2%	-187 M	-283 M	-360 M	-421 M
3%	-155 M	-236 M	-300 M	-351 M
4%	-124 M	-188 M	-240 M	-280 M
5%	-93 M	-141 M	-180 M	-210 M
6%	-62 M	-94 M	-120 M	-140 M
7%	-31 M	-47 M	-60 M	-70 M

At <=5%, Spotify deal would be cheaper than our lowest cost FOP

With current proposal, we're at risk of an economic loss WITHOUT transaction caps

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Alternative Processing Scenarios

Play processes all GC/DCB txn; NO CAP*

	Economic Outcome (USD Ms)			
Eff. Rev Share	**2021**	**2022**	**2023**	**2024**
1%	-66 M	-100 M	-128 M	-149 M
2%	-35 M	-53 M	-68 M	-79 M
3%	-4 M	-6 M	-8 M	-9 M
4%	27 M	41 M	53 M	61 M
5%	58 M	88 M	113 M	131 M
6%	89 M	135 M	173 M	202 M
7%	120 M	183 M	233 M	272 M

- 31.3% of A&G spend processed by GC/DCB in the last 12 months
  - **Table above does *not* account for additional risk of CC processing**

Txn cap set @ 20% of spend*

	Economic Outcome (USD Ms)			
Eff. Rev Share	**2021**	**2022**	**2023**	**2024**
1%	-31 M	-47 M	-60 M	-70 M
2%	0 M	0 M	0 M	0 M
3%	31 M	47 M	60 M	70 M
4%	62 M	94 M	120 M	140 M
5%	93 M	141 M	180 M	210 M
6%	124 M	188 M	240 M	280 M
7%	155 M	236 M	300 M	351 M

- If we set a txn processing cap @20% of total modular billing spend, **Play is profitable above a 2% effective rev share**
  - Mitigates processing risk above the cap

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**Both tables assume avg. processing cost of 10%*

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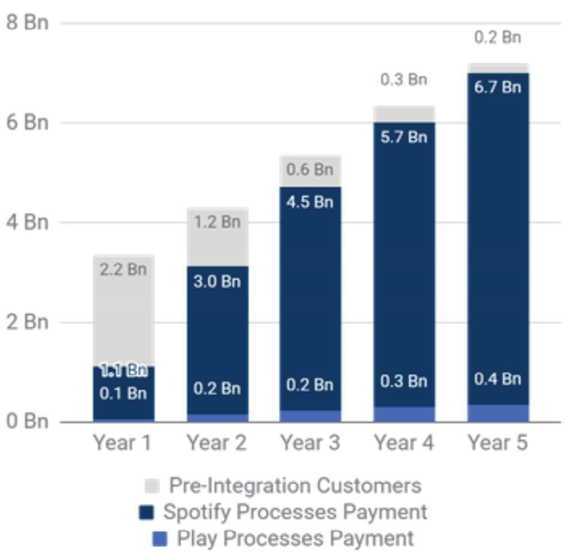
Spotify has the potential to be big on Modular Billing

Spotify Android Spend



<u>Basis for estimate:</u>

- Spotify 2020 revenue guidance of $9B (x-Platform)
- 25%+ growth rate in 2020 (tapers to ~10% by 2024)
- 4-5% monthly churn rate
  - Very low comp avg. sub churn on Play

<u>Spotify expected to be the largest dev on Play</u>

- Next largest = NCSoft @ $1.1B spend LTM
- Total Spotify spend (across all of modular billing) =12% of current 2024 Play Spend forecast

Google

- Extra datapoints on Spotify’s guidance and how our model stacks up:
- Android spend forecast in the model for 2020 is $3.4B, which compares to Spotify's 2020 guidance of $8.7B-$9.2B (converted to USD from EUR). This implies Android would have a 36-38% share of Spotify's revenue.
- Android MAU at YE 2020 is forecast to be 231M, which compares to the guidance range of 328M-348M, implying Android would have a 79-83% share of total Spotify MAU.

EXHIBIT 1496.R-020

Spotify Counter Proposal Matrix

New In-Scope Spotify Premium Gross Adds:	*Payment processed by Spotify*	*Payment processed by GPB*
Acquired via Google Growth Marketing	**Developer Processed Fee + Additional Bounty* (e.g. +50% of 1 month)**	**Standard Fee + Additional Bounty* (e.g. +50% of 1 month)**
All Other Users	**5% of 1 Month**	**1 Month**

Features:

- **Service fee** on in-scope new adds:
  - **Standard Fee (1 Month)** on GPB processed adds
  - **Developer Processed Fee (5% of 1 month)** on Spotify processed adds
- Additional bounty* (e.g. **50% of 1 month**) paid on user acquisition attributable to Google Growth Marketing

Implied bounty range:

- ***74% of sku*** if Google acquires 100% of subs
- ***24% of sku*** if Google acquires 0% of subs

Upcoming Play Billing Policy Change

To promote user trust and safety and ecosystem fairness, policy language will be clarified and developers will receive ample time to come into compliance

Policy Change Announcement

- Play-distributed apps must use Google Play's In-App Billing system if they accept payment for access to features or services within the app. This includes payment for access to app functionality and digital content or goods.
- Developers will have until September 2021 to come into compliance
- Brings Google Play in line with Apple's iOS app store policies

Impact to Partners

(including Spotify)

- By September 2021, all developers will need to either:
  - Accept in-app payments using Google Play Billing (and pay associated service fee)
  - Not accept in-app payments & be consumption only
- (Note: Spotify's existing customers will not impacted by this change)

2019 Balance of Trade with Spotify

Key Takeaway: Google may be able to pursue future xPA deals with Spotify, but adding elements from other product areas here may slow down the negotiation without adding significant value

			2019 Gross Revenue ($M)	
Product Area	Active Deal or Relationship Area	Expiration	To Spotify	To Google
Cloud	**GCP Storage Agreement** *3 year $450M commit in 2018*	Q1 2021	--	$248M
Hardware	**Google Mini Distribution**	N/A - HW deal included multiple consideration elements, not purely based on revenue		
LPS	**AdX (Ad Manager)**	March, 1 2021	$66M *Programmatic audio contributed $23M*	$20.6M *Includes platform fees + rev shares for programmatic demand*
LCS	**DV360** *Spotify also has a DVIP*	Q1 2021 for DVIP	--	$33.3M
	Universal App Campaigns		--	$33.5M
	Search (Non App Promo)		--	$27.7M
		Total	**$66M**	**$363M**

- Additional appendix slides here - https://docs.google.com/presentation/d/18gslC3r2l8-2bXxmlQdXReGybVQ99kW7JiyH2M-nTnw/edit#slide=id.p

Gives & Gets

Spotify Gets

- **Maintain unique payments capabilities** while complying with Google Play policies
- **User acquisition and global expansion support** through merchandising on high visibility Play store surfaces
- **Incremental FOP penetration** with Google sharing stored user credit card details
- **Monetization and Buyer conversion support** through
  - **Google Play's 250+ forms of payments** across 152 markets, with many more launching and
  - Access to **very large base of Google Play MAU with FOPs on file.**
  - Growth Marketing - new buyer acquisition program reaching ~500M users
- **M1-M2 Retention and Re-engagement support** across various proprietary channels & business consulting
- **Customer Service support** through GCS and Subscription Centre
- **Enhanced fraud detection**

Google Gets

- **Spotify integrates with Google Play Billing**
- **Revenue structure** that incentivizes Google to support Spotify's subscriber growth
- No carve outs on Month 2 charge
- Standard winback period
- VAT inclusive

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Metadata

All Custodians	Donald Harrison;Feng, Paul;Kochikar, Purnima;Paul Feng;Purnima Kochikar;Samat, Sameer;Sameer Samat	SEMANTIC
Author	Tamzin Taylor (Google)	SEMANTIC
Date Created	07/27/2020 12:43 pm	SEMANTIC
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